

EVALUATING CONTRACT NEGOTIATION STRATEGY FOR PT XYZ

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Abstract— *Oil and Gas operations are the hazardous operation and need huge amount of capital, since then finding efficient resources for this business is critical to eliminate Non Productive Time (NPT) and incident. NPT is near to cost control failure because operation failure means deviation in cost versus budget. The resources needs in this industry should meet the international standard for Oil and Gas. While for high technology services, this is an oligopoly market as already well-known that there is only small amount of Service Company that able to give that such of services that are worldwide class of Service Company while this Company in the research is not listed in Worldwide Oil and Gas Company. To face that situation, Company needs to have high bargaining position and good negotiation strategy to get the best service to support their operation. This research is focusing on finding out the current negotiation strategy in Company and other Company as reference and also doing case study of contract with 1 (one) Worldwide Service Company that has been Company's partner for a long time. After knowing those, this final project creating initiation material for Company's negotiation guideline based on Company's and other Company's lessons learnt. Next is comparing the current condition with 3-D Negotiation theory to get better strategy in negotiation and higher bargaining position during negotiation with Worldwide Service Company. The results of this final project are recommendations for Company about material of negotiation guideline for Company to get better negotiation strategy and higher bargaining position, supporting tools for negotiators during negotiation preparation process, topic for further study to define the advantages and disadvantages of using existing supplier compare to the new one and enhancing negotiator skill with second and third dimension of 3-D negotiation.*

Keywords: negotiation, negotiation process, 3-D Negotiation, BATNA, ZOPA, negotiation strategy, negotiation tactics, Oil and Gas Company, negotiation tools, Supply Chain Management

1. Introduction

Worldwide large Oil and Gas Company are mostly from Middle-East since the oil reserve in there are very huge. Based on Petrostrategies.org, Figure 1 and Table 1 show the world's largest Oil and Gas Company based on their oil equivalent reserves. On Table 1, Pertamina of Indonesia is in 32nd position worldwide for their reserve. Doing business in Oil and Gas industry will never be separated from the needs of Service Companies to fulfill the Oil and Gas Company needs of service and material, from the simplest thing to the high-end technology in supporting the operation. Based on Petrostrategies.org, Table 2 show the world's largest Oil and Gas Service Company based on their market capitalization.

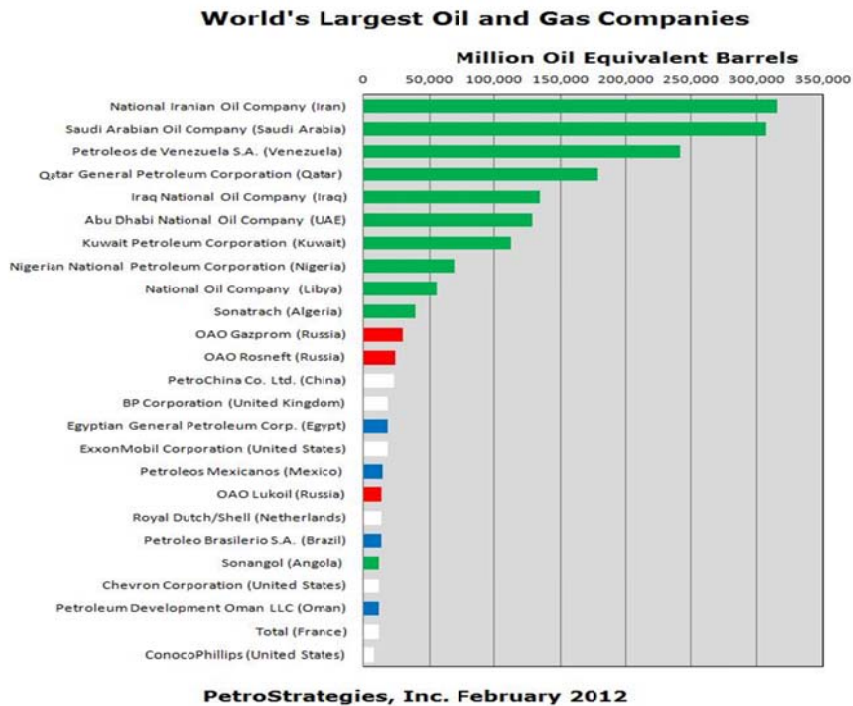


Figure 1. World's Largest Oil and Gas Companies (Source: Petrostrategies, Inc., 2012)

PT. XYZ as describing in their website is focusing on oil & gas exploration and production that working areas are in Indonesia and other countries. This Company was found by Indonesian businessman in June 1980 that then started to capitalize in 1994. In 2004, this Company was rebranding to raise the Company value with the new brand, vision, mission, value and strategy. Procurement process is important for this Company as a Government Contractor in Oil and Gas business to support its operations. In this Company, procurement is proceed by Supply Chain Management (SCM) Division while in this writing subject will be limited to Service Procurement only.

Oil and Gas operations are the hazardous operation and need huge amount of capital, since then finding efficient resources for this business is critical to eliminate Non Productive Time (NPT) and incident. Since NPT; not only in Oil and Gas Industry, is near to cost control failure because operation failure means deviation in cost versus budget. The resources needs in this industry should meet the international standard for Oil and Gas business and the procurement process should comply with Government regulation that in Indonesia is represent by BPMIGAS which applying PTK-007 rev.02 (Pedoman Tata Kerja) as procurement regulation for Oil and Gas business.

Table 1. Oil Equivalent Reserves Rank by 2010

Rank by 2010 Oil Equivalent Reserves	Company	Worldwide Liquids Reserves, Million Barrels	Worldwide Natural Gas Reserves, Billion Cubic Feet	Total Reserves in Oil Equivalent Barrels, Million Barrels
1	National Iranian Oil Company (Iran)*	137,010	1,043,670	313,737
2	Saudi Arabian Oil Company (Saudi Arabia)*	260,100	273,200	307,143
3	Petroleos de Venezuela S.A. (Venezuela)*	211,170	178,860	241,744
4	Qatar General Petroleum Corporation (Qatar)*	25,380	893,800	178,508
5*	Iraq National Oil Company (Iraq)*	115,000	119,940	133,503
30	Suncor Energy Inc. (Canada)	4,372	2,036	4,920
31*	Dubai Petroleum Company (UAE)*	4,000	4,000	4,684
32*	Pertamina (Indonesia)*	903	20,338	4,414
33	Canadian Natural Resources (Canada)	3,228	3,575	3,570

Table 2. The world's largest Oil and Gas Service Company based on their market capitalization Petrostrategies, Inc., 2010

Rank by Market Capitalization	Company	Industry Segment	Market Capitalization, \$ Million
1	Schlumberger Ltd.	International Integrated	39,775
2	Halliburton Company	International Integrated	17,244
3	Baker Hughes Inc.	International Integrated	9,367
4	Transocean Sedco Forex	Offshore Drillers	9,330
5	Weatherford International	Oilfield Equipment	6,065
6	Nabors Industries	Onshore Drilling	5,271
7	Diamond Offshore Drilling Company	Offshore Drillers	4,963
8	Noble Drilling Corporation	Offshore Drillers	4,823
9	ENSCO International	Offshore Drillers	4,119
10	BJ Services Company	Oilfield Equipment	4,534

Oligopoly market for service supply in this business had making a low bargaining position for Company compare to worldwide Service Company. This low position could complicate the tender process especially in negotiation process. That could be negotiation in contract term and condition, scope of work and price. While in actual business dealing with those worldwide Service Companies are often happen as illustrated in company's Contract Map in Figure 2. This figure shows contract map in this Company since 2001 until 2015 which limited to Service Contract with minimum value of USD. 1 Million. Based on Company's BPM system, there are 22 contractors with total contract value of USD. 502,831,558.61 from 2001 until 2015. Focusing on worldwide Service Company, there are 4 Service Companies listed in World's Largest Service Company in above table that serving service in this Company, that are Halliburton, Schlumberger, Weatherford and Baker. Service from those 4 (four) Service Companies for 2003 until 2015 is USD. 174,260,162.42 or 35% from total contract amount. From these 4 Service Company, Halliburton handle 65% contract, Schlumberger handle 28% contract, Weatherford handle 4% contract and Baker handle 3% contract as illustrated in Figure 3.

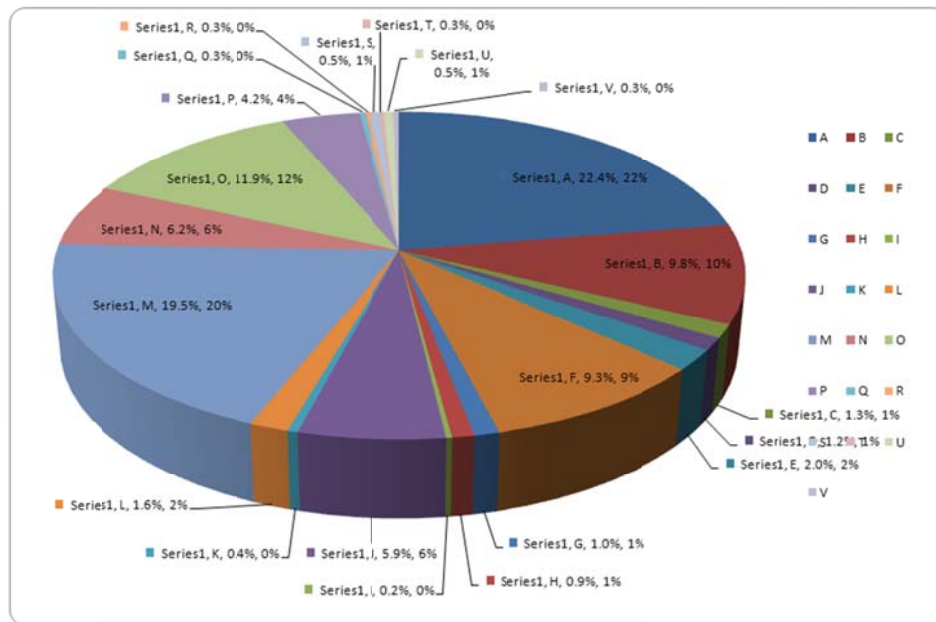


Figure 2. Service Contract Map for 2001-2015

From those contract facts, it could be seen that Company should make a deal with World's Largest Service Company while this Company has not listed in Worldwide Oil and Gas Company. This fact gives a big impact during agreement process between Company and Worldwide Oil and Gas Service Company.

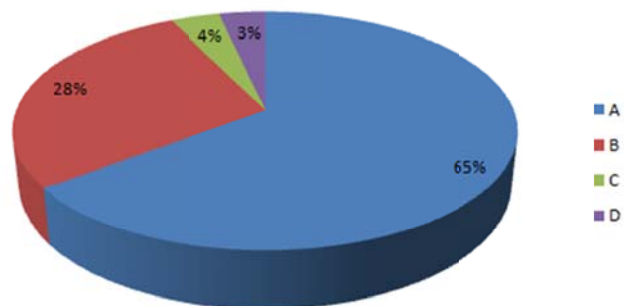


Figure 3. Service Contract supplied by World's Largest Service Companies for 2003-2015

Service procurement process in this Company could be held using 1 (one) or 2 (two) envelope system refer to PTK-007 rev.02. Evaluation process in this tender is held in parallel, first committee will evaluate the administration aspect then followed by technical aspect and the last is commercial. Negotiation process will be held during commercial evaluation if the quotation did not meet Company's Owner Estimate. Negotiation meeting should be conduct by Bid Committee chairman and Buyer with collaboration with User. They should analyze, prepare for negotiation and sometimes defining strategy for on the table negotiation, but the last step usually forgot by the team.

Based on regulation, Best Alternative to a Negotiated Agreement (BATNA) for negotiator in this Company is doing rebid if the previous tender got fail and the do Direct Appointment to chosen Contractor with some justification approved by authorities. Since Oil and Gas Company is Government's Contractor, and BPMIGAS is the authorized institution to handle this sector then every planning and budgetary in this Company should be consulted and approved by BPMIGAS. Zero mistake should be apply in this industry since there will be 3 (three) auditors that audit Oil and Gas Company performance. If agreement could not be achieve in negotiation process to lower quotation as the same amount as Owner Estimate, Company could increase the Owner Estimate into 10% above Owner Estimate refer to the regulation. Then Zone of Possible Agreement (ZOPA) for Company is between quotation and Owner Estimate.

2. Business Exploration

To support Company operation, Service Procurement and users preparing bundling contract for several years that covered many projects with huge contract value that usually more than USD. 1 million. Those kinds of contracts have high equipment specification and should be performed with special skill that usually can only be provided by Big Scale Enterprises which have long experience. Big Scale Enterprises with special skill and long experience that could supply Services for Company in Indonesia is very limited and well known and usually listed in Worldwide Oil and Gas Service Company. This is an oligopoly market that complicates Company in processing tenders. In every tender for bundling contract, the bidder are only those Big Scale Enterprises that usually quote a high number for the services and the price is increasing in every new tender in the next year. Increasing in contract value will be impacting project cost and Company operation cost. Way to control the increasing contract value as a result of tender is to improve Company's bargaining position and negotiation strategy.

A. Conceptual Framework

This research Conceptual Framework could be explained as illustration in Figure 4.

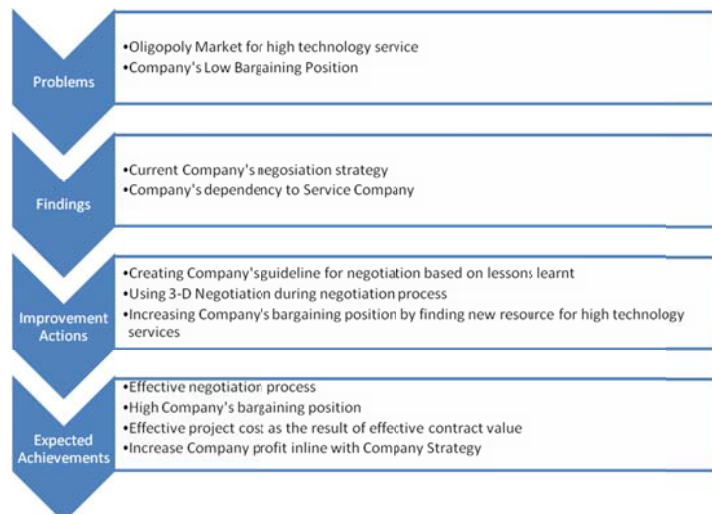


Figure 4. Research Conceptual Framework

4 (four) sections of research Conceptual Frameworks are Problems, Findings, Improvement Actions and Expected Achievements.

1. The Company problems in procurement process are dealing contract in Oligopoly Market for high technology service and low bargaining position during negotiation. Commercial result of those tenders always high above Company's Owner Estimate and negotiation for those contracts are very hard since there is less competition for Service Companies.
2. Findings from this research could be classified into two things; those are current Company's negotiation strategy and Company's dependency to Service Company. Current negotiation strategy will be gathered from interview with Company's negotiator while case study will show Company's dependency to Service Company.
3. Improvement Actions that could do to overcome the problems are creating Company's guideline for negotiation based on lessons learnt, using 3-D Negotiation method during negotiation process and increasing Company's bargaining position by finding new resource for high technology services.
4. Expected Achievements from those actions are more effective in negotiation process, get high Company's bargaining position, more effective project cost as the result of effective contract value and get more Company profit in line with Company Strategy.

B. Method of Data Collection and Analysis

This research generally consists of 3 (three) main processes as illustrated in Figure 5 that consist of Studying Company experiences, Benchmarking from other Company and Analyzing key success factors and lesson learnt.

1. Studying Company experiences by collecting service contract data of long term contract with value above USD. 1 M, interviewing Company's negotiator to know the negotiation style and strategy and case study of one service supply that has complex problem in the Company
2. Benchmarking from other Company by interviewing the other Company's negotiator in order to find reference of negotiation style and strategy in similar industry. There are 2 Company which name Company A and Company B in this research. Company A is multinational Oil and Gas Company listed in Worldwide Oil and Gas Company while Company B is a local Company and not listed in that list. Reason to choose these two Companies is to compare the negotiation strategy between Medco E&P Indonesia with multinational Company as well as local Company. The researcher believe that Company A have a high bargaining position during negotiation with Contractors since their position in worldwide industry is equal while Company B have lower bargaining position in the same level with Medco E&P Indonesia as the same local Company.
3. Analyzing key success factors and lessons learnt by analyzing data gathered from interview result from Company's Personnel and compare with interview result from other Company's Personnel. This step has purpose to find key success factor negotiator to build the best negotiation strategy for Company. And also analyze case study to find solution for complex tender.

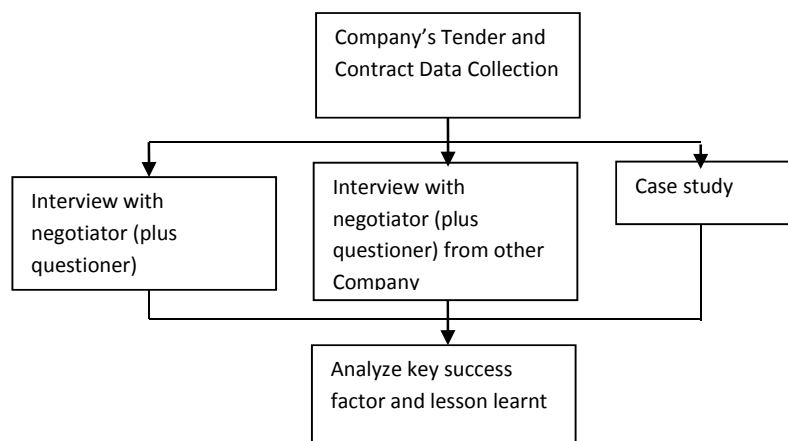


Figure 5. Research Methodology

C. Analysis of Business Situation

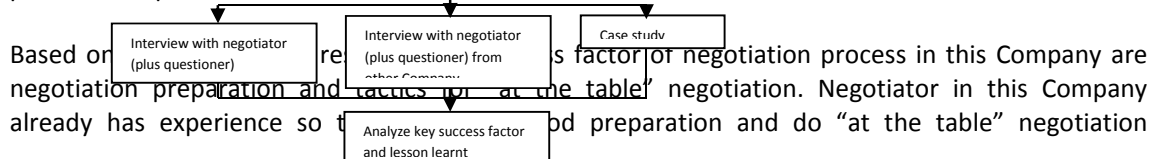
There are 16 persons that get involved as correspondents in this interview. 14 correspondents are from the Company and 2 correspondents are from other Companies. Data gathered from those interviews can be summarizing that there is no much difference answer between Company's correspondents and other Company's correspondents. For case study in this research, Cementing service supply by one of Worldwide Service Company (X) is chosen. Service contracts by X in this Company since 2009 until 2014 are listed in Table 6. There are 11 contracts exist since 2009 until 2014 where 8 of them are Cementing Service Contracts and 3 others are non Cementing Service Contracts. Total Contract that serves by X is USD. 29,718,152.24 with USD. 22,784,878.29 is for Cementing Service contracts. From 8 Cementing Service Contract, there are 5 contracts that held by Direct Appointment in the tender process.

X is very difficult to negotiate. This indication could be seen in the comparison between OE and negotiation result that always slightly difference from OE while in other side User usually increase the OE in every new tender as preparation if the Contractor does not want to lower the price until OE or 10% above OE in previous tender. This is because based on regulation that stated in PTK-007 rev.02; tender will be fail if quotation price is more than 10% above OE. So user always give spare for in case Contractor quote 10% above previous OE, but actually Contractor will quote 10% above current OE.

In 2011, the Company gets other resource for Cementing Service Contract which is Company Y. This Service Company is a new comer in worldwide Cementing Service and not listed yet in World's Largest Service Company list. This new resource obtained from Competitive Bidding tender where X is also one of the bidders. At the commercial evaluation, it can be seen that the price that offered by Company Y is 15% below OE while X offered high quotation above that. In that tender User created OE refers to previous contract which X was the existing contract holder. Based on tender result, it can be seen that Company's X quotation is much lower than Y quotation. This is favoring the business and also project financing since their estimated cost could be much lower than their budget. Company Y quotation compare to OE is shown in Table 4.

Based on contract, Company Y holds Cementing Service contract for 3 years since July 1st, 2011 until June 30th, 2014. This contract is covering Cementing Service for Company's all area. At the beginning of the contract in 2011, Company Y performance was not satisfying User in 1 (one) field since they made a mistake that causing operational problem. Based on investigation, this failure caused by technical problem especially personnel. User found that Company Y's personnel having low competence to run their project although based on experience in tender document; they already meet the required specification. During investigation, some says that the failure caused by incompetent personnel and some says that the failure caused by unfamiliar personnel with the new field. Finally, Company made a conclusion that Company Y's personnel were incompetent to performing jobs in Company's area. For this reason, Company reduce scope of contract with Company Y from giving service for all Company's area into 1 (one) small field with low risk job. While to cover other Company's area, User create Direct Appointment tender to X in 2012.

Based on this fact, it is known that high technology service is not easy to find to support Company operation. Worldwide already know very well that X is the best Service Company for Cementing service, and it is not favorable for Company since this could lower the Company's bargaining position compare to X.



smoothly unless no guidance that they have. They also still have good relationship with Contractor after a tough negotiation. Lesson learns from interview illustrated in Table 3. While findings from case study are Company's high dependency to 1 (one) Service Company and Company need to find new resource of Cementing Service suppliers.

Table 3. Lessons Learnt from Interview

Negotiation barriers	Actions to overcome barriers
<ul style="list-style-type: none"> - Bad planning in technical and commercial - Not preparing list of thing to negotiate - Not preparing variable for exchange - Request for changes in contract's term and condition 	Have better understanding about technical specification
<ul style="list-style-type: none"> - Bad preparation of scope or work, budget and market price analysis - Incompetent negotiator 	Do better preparation in tender scope of work, budget and market price analysis
Far price range between quotation and OE	Count for price escalation during planning process
<ul style="list-style-type: none"> - Single bidder in tender process so there is no competition - Not knowing other resources - Alternative service offering 	Widen PQ requirement to get more bidder
Urgency of work that make negotiator has no room and time to make a deep analysis	Speed up procurement process

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3. Business Solution

Based on finding in interview, Company already have key success factors in negotiation process which are negotiation preparation and tactics for "at the table" negotiation. This means that negotiator in this Company already applied the first dimension of 3-D Negotiation theory. But to achieve more effective result, Company needs to apply second and third dimension of 3-D Negotiation method. Since until now Company often loose in negotiation process with Worldwide Service Company.

As explained in 3-D Negotiation theory (Lax, D.A., & Sebenius, J.K., 2006), to apply the second dimension of 3-D Negotiation method, Company needs to claim value that including bring new player

in the oligopoly market. Company had done this once but the new comer was technically failed in performing the job. In this case, finding other resources is rather difficult but Company could educate the new resource to be familiar with Company's job. Lax, D.A., & Sebenius, J.K. also explained in their book that to apply the third dimension of 3-D Negotiation method, Company needs to define new interest and new BATNA - Best Alternative to a Negotiated Agreement. Current negotiator interest during negotiation process could be focusing on service price only, while other interest that might Company has are many such as easy service access in emergency situation, being the first priority for a rare tools, transfer knowledge from Service Company to Company and other interest that might be useful for operation beside cost. Those kind of interests could improve Company's BATNA since negotiator focus now is not only on service price but also including other qualitative advantages.

For barriers in negotiation process that found in interview, those could be caused by Lack of knowledge in technical specification, Lack of knowledge about the market including market price, Time limitation and Oligopoly market. To overcome the barriers, some negotiators already have actions that could be share to other negotiators as reference then Company should make documentation so that they could use that as database.

Based on finding in case study, Company has high dependency to 1 (one) Service Company. This Service Company has high bargaining position since they are one of the big players in oligopoly market. This dependency happens because there are limited suppliers for this service. Since then, Company has to accept any price that they quote except if Company has other resource. This is Company's home work to find other resources.

4. Conclusion and Recommendation

Based on the research's analysis compare to 3-D Negotiation theory, this Company already applies the first dimension of this theory but lack of second and third dimensions. This Company already has some best practices for the first dimension that could be use as negotiation guidance since they do not have reference or guidance yet for negotiation process. For that reason, negotiator in this Company doing negotiation based on experience and self knowledge while in their daily activity, they have to make a deal with worldwide Service Companies that have stronger position and high bargaining position. Best practice from other Company also could be use to enrich negotiation skill for their personnel.

Table 4. Conclusions

Interview:	Case Study:
<ol style="list-style-type: none"> 1. First dimension (tactics) already applied 2. Second and third dimensions which are "deal design" and "setup" are not applied 3. Company already has best practices for the first dimension that could be use as negotiation guidance 4. Best practice from other Company also could be use as reference, such as tactic for enemy, invite bidder to Company's office which means many Company's personnel than bidder 	<ol style="list-style-type: none"> 1. Company often ends up in 1% (one percent) difference of Owner Estimate and Negotiation result 2. Company usually positioned as a weak party during negotiation since they have no choice of supplier 3. Need more study about the advantages and disadvantaged of using existing supplier compare with the new resource

Refer to case study that explained in previous chapter, this Company often ends up in 1% (one percent) difference of Owner Estimate and Negotiation result. This Service Company and other worldwide Service Company are very strong and they have a high bargaining position. Company usually positioned as a weak party during negotiation since they have no choice of supplier. Once they get another resource, the new supplier have had problem with technical and operational aspect. But there still need more study about the advantages and disadvantaged of using existing

supplier compare with the new resource that covering financial aspect, Company strategy, operational and also technical aspects.

Based on actual condition, negotiators in this Company do manual analysis in every negotiation since they do not have tools to analyze tender and contract data. They also should grab and collect contract and tender data they need manually since the data in BPM system is a raw data. This may take longer time to collect and analyze data compare to if they have a final data in their system. Conclusions in this research are shown in Table 10.

Recommendations for this Company are:

Company's personnel should do following steps to get a smooth negotiation:

1. Clearly define the objectives of contract negotiation
This step may consist of Company's financial impact, Fitted term and condition to regulation and required scope of work, Operational schedule, Technical specification, Knowledge transfer for Company's personnel and Mutual relationship.
2. Prepare for the negotiation
This step needs collaboration of many divisions to get a complete preparation, such as Supply Chain Management, User, Legal, Finance and other divisions if necessary. For complex cases, preparation that involves external parties is needed such as BPMIGAS, other Company (partner) or Insurance Company.
Preparation based on Company's best practice founded in this research that could apply are Know Company's strengths and bargaining position, Know the market condition (*), Know manufacturer's price (*), Know counterpart's background and technical specification, Choose tactics, negotiator and prepare strategy for dead lock, Make list of item to negotiate, Prepare variable for exchange, Review and compare all quotation from all bidders (*), Review quotation trends from similar service in previous tenders (*), Review detail technical specification, Overlook actual situation at that time and predict anything that could be happen and Synchronize everything, look from every angle and possibility
(*) need tools in Company's system
Other preparation consideration based on other Company's best practice founded in this research that could apply are Market survey, technical survey, properness evaluation and performance evaluation
3. Define tactics for "face to face" and "at the table" negotiation
Choose some tactics that fit to current condition on the table. Tactics based on Company's best practice founded in this research that could apply are Build the same perception using persuasive way, Never give pressure but responsibilities to make them understand our needs, Give pressure to stubborn Contractor, Control negotiation process by giving many questions, Don't give something without taking something, Respect the counterpart, Negotiate directly with the decision maker, Use prevailing market value as reference, Being transparent about approved budget from BPMIGAS, Give lure by saying that this is a pilot project, Compare quotations from all bidders and Equalize technical understanding
Other tactic based on other Company's best practice founded in this research that could apply is use tactic for enemy, invite bidder to Company's office which means many Company's personnel than bidder.

To support the preparation step as above recommendation and ease the negotiator in grabbing data, Company need to equipped their personnel with these tools:

1. Market survey tools
This tool is needed to know current market condition. It should consist of all service's specification and price data bank gathered from Contractor's quotation or benchmarking result from other Oil and Gas Company or data from BPMIGAS. Negotiator will grab market

data for current tender reference from this tool rather than doing market survey by themselves before negotiation.

2. Manufacturer's price tools

This tool is needed to know current manufacture's price. It should consist of manufacture's price for all services gathered from manufacturer or data from BPMIGAS. Negotiator will know manufacturer's price as their calculation base line in negotiation and will be able to decrease Contractor's overhead as low as possible.

3. Quotation comparison tools

This tool is needed to compare between each quotation for current tender. Negotiator will easily know the comparison of each line item in all quotation and could use those data during negotiation.

4. Quotation trends for similar service tools

This tool is needed to know pricing trends for the service. It should consist of contract price for all services used in the Company. Negotiator will know the pricing trends for current tender so that they can use this as their reference in making price estimation for negotiation.

These tools are needed since this Company often makes a deal with worldwide Service Companies that have a strong market intelligent and high bargaining position. For that reason this Company needs to strengthen their database and equipped themselves with valid data to overcome the strong counterparts. Those tools will avoid Company of losing data if their personnel are not working because of employee turnover or retirements. Beside of negotiation purposes, these tools also applicable and will be useful for User in creating their Owner Estimate as explained previously in negotiation barriers that User also need tools to know better about market survey and other price.

Based on this research, it is better to collect the barriers of negotiation and the overcome actions and keep those in guideline as Company's negotiator reference so these data will still in Company's record although the employee is no longer employed. Company need to do deep study about the advantages and disadvantaged of using existing supplier compare with the new resource that covering financial aspect, Company strategy, operational and also technical aspects. This study is needed to define clear Company's bargaining position compare to Service Companies and eliminate dependency to 1 (one) Service Company.

Refer to 3-D Negotiation theory, this Company need to enhance their personnel skills in second and third dimension which are:

1. Deal Design (second dimension)

Need more focus on value and substance that could gain from the negotiation. Company could educate the new resource to be familiar with Company's job since finding other resources is difficult.

2. Set up (third dimension)

Need more focus on scope and sequence before the negotiation and out of the table. Company needs to define new interest and new BATNA - Best Alternative to a Negotiated Agreement. Other interest for example easy service access in emergency situation, being the first priority for a rare tools, transfer knowledge from Service Company to Company and other interest that might be useful for operation beside cost. That kind of interest could improve Company's BATNA since negotiator focus now is not only on service price but also including other qualitative advantages

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